

Stylus Energy Inc. (TSX: STY) – Fundamentals Remain Strong; Positive Developments in Q1-2007; Final Report

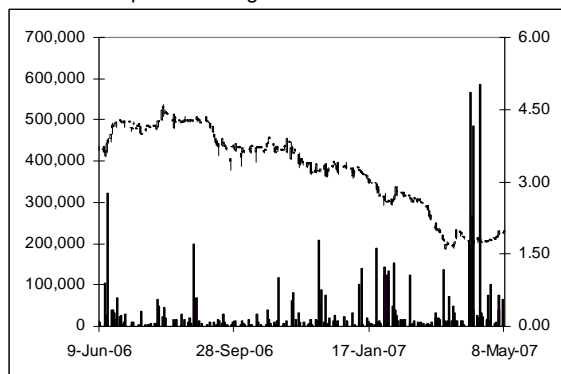
Sector/Industry: Junior Oil & Gas

www.stylusenergy.com

Market Data (as of May 8, 2007)

Current Price	\$1.75
Fair Value	\$3.75 (↓)
Rating*	BUY
Risk*	3 (Average)
52 Week Range	\$1.60 – \$4.60
Shares O/S	27,670,910
Market Cap	\$54.23 million
Current Yield	N/A
P/E	N/A
P/B	0.93
YoY Return	-47.6%
YoY TSX Comp	13.2%

*see back of report for rating and risk definitions



FY2006 Highlights

- FY2006 revenues increased 5.4% YOY, from \$21.21 million in FY2005, to \$22.36 million in FY2006. STY had a net loss of \$3.64 million (eps: -\$0.14) in FY2006, compared to a net profit of \$1.54 million (eps: \$0.08) in FY2005. Revenues were lower and net losses were higher than expectations due to lower production revenues resulting from lower natural gas prices and higher costs.
- The company tied-in their 600 boepd net behind-pipe capability at Vulcan in early 2007. As a result, production increased from an average of 1,479 boepd in Q4-2006, to the current production of 2,000 – 2,100 boepd. STY also has an additional 300-350 boepd net shut-in at Champion.
- We believe that Champion could be the next Vulcan for STY. Since its discovery in 2005, Vulcan has moved up the ladder and is now the biggest producing property for STY.
- We continue to maintain our positive outlook on both oil and natural gas prices, and expect prices to stay above US\$55.00/bbl and C\$7.50/mcf, respectively, until 2013.
- Based on our production forecasts, we expect revenues to increase by 76% in FY2007.

Key Financial Data & Statistics

(in C\$)	2004	2005	2006	2007E	2008E
Production (boepd)	543	1,056	1,383	2,250	2,500
Production Revenues	7,703,744	21,208,165	22,357,569	39,353,826	45,640,393
Revenues / boe	38.77	55.04	44.29	47.92	50.02
Operating Netback	21.96	34.42	22.86	26.81	28.48
Net Income	(761,142)	1,544,165	(3,640,454)	(285,271)	(279,436)
EPS	(0.07)	0.08	(0.14)	(0.01)	(0.01)
Working Capital	1,181,004	(7,090,477)	(23,023,961)	(23,609,213)	(23,886,337)
Assets	23,811,020	67,648,283	97,103,112	109,752,031	115,251,848

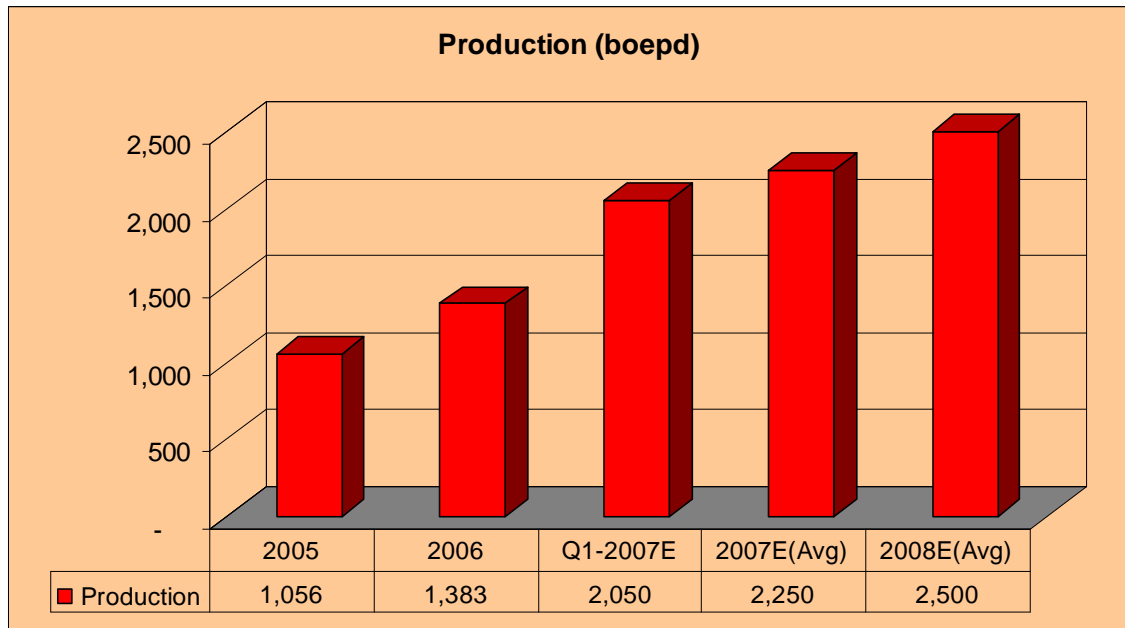
Stylus Energy Inc.(TSX:STY) is a Calgary – based oil and gas exploration and production company mainly focusing on natural gas production in Alberta. Currently, Stylus has 4.01 million barrels of oil equivalent (boe) proved and probable reserves, and has a current production level of 2,000 – 2,100 boe per day (boepd). Production is 84% natural gas and 16% oil and natural gas liquids.

Reserve estimates increased

According to the latest reserve report (end of 2006), STY increased its proved reserves to 2.52 mm boe (1.87 mmboe net), and proved and probable reserves to 4.01 mmboe (2.97 mmboe net). About 54.7% of the proved and probable reserves were categorized as ‘developed producing’. The previous estimates, as of December 2005, were proved reserves of 2.37 mmboe (1.81 mm boe net), and proved and probable reserves of 3.42 mmboe (2.60 mmboe net).

Production Update

The chart below shows STY’s growth in production since Q1-2005.



Q4 – 2006 Production: STY had forecasted average production of 1,500 to 1,550 boepd during Q4-2006. However, actual average **production during the period was slightly lower than estimated at 1,479 boepd**. Production in Q4-2006 decreased due to facility issues resulting from high line pressures on the Nova sales line at Hangingstone, an engine failure at Sousa, and a pipeline break at Portage, in addition to delays in receiving the GPP approval that STY was awaiting at Vulcan. The lower than estimated production in Q4-2006 negatively affected the company’s financials in the period (as mentioned later in the report).

Current Production: At Vulcan, about 600 boepd (net) from 4 (2.0 net) gas wells were shut-in pending the Alberta Energy and Utilities Board (AEUB) approval of the company’s Good Production Practice (GPP) application regarding the Vulcan Basal Mannville G Pool. The company received approval in January 16, 2007, and **increased its production from average production of 1,479 in Q4-2006, to 2,000-2,100 boepd, which is the current production rate. STY also has an additional 300-350 boepd net shut-in from several intermediate and shallow natural gas zones at the company’s new focus, Champion.**

In addition to the Q1-2007 production increase at Vulcan, STY has reinstated some of the production that was shut-in in Q4-2006. We believe the company has completed the repair at

Portage, and have restored production (in Q1-2007) that was suspended (16 boepd net). With regards to Hangingstone South, about 50% of production (110 boepd net) that was shut-in during Q4-2006 has been reinstated, but the 3rd party plant continues to have problems with high line pressure. Management indicated that in Q2-2007 they are trying to divert most of the production to another gas plant that is not affected by high line pressures.

Production Forecast: We expect STY to tie in 300-350 boepd net production at Champion by September – October 2007. The company is also expecting to add another 50-60 boepd net from its Bow Island Valley reservoir (newly discovered pool) in 2007. We **expect average production for STY of 2,250 boepd in 2007, and exit 2007 production of 2,500 boepd.** We believe that both these estimates are quite conservative.

Reserve Ratios and F&D Costs

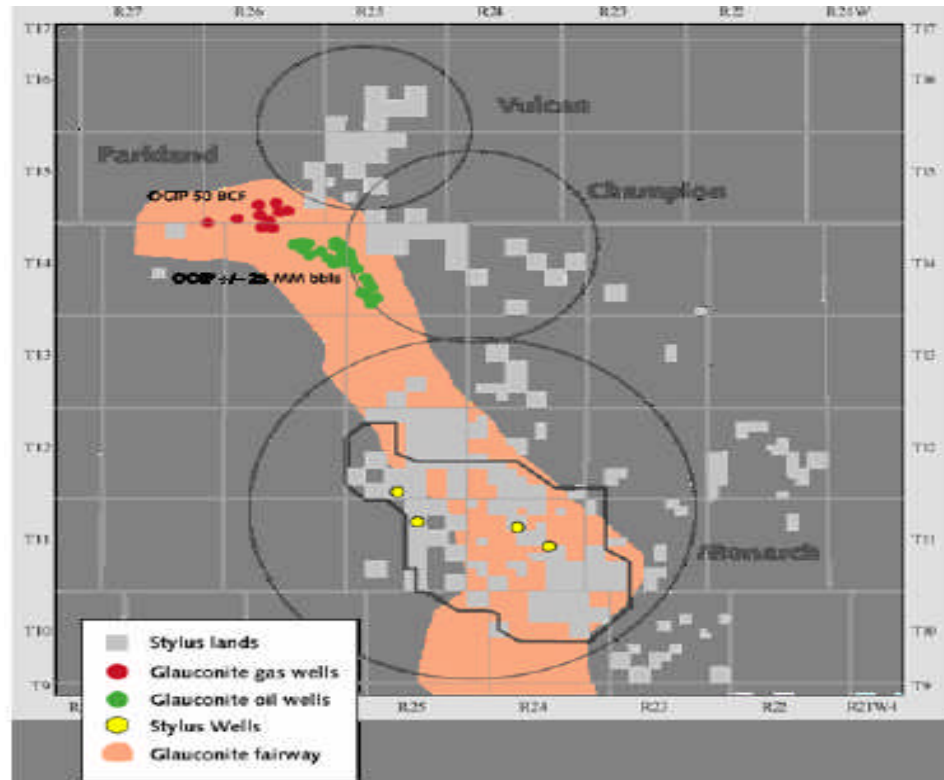
The table below shows STY's reserve ratios and F&D costs at the end of 2006 compared with 2005.

Reserve Ratios & F&D Costs	2005	2006
F&D Costs	\$36.45	\$39.04
RLI	8.90	7.40
Recycle Ratio	1.22	0.59
Reserve Replacement Ratio	5.90	2.20

We believe the company had reasonable reserve ratios at the end of 2006 for a junior E&P company. As a result of the Kinloch acquisition, STY had considerably added to its proved and probable reserves (by more than 200%) in 2005, and hence we believe that reserve ratios at the end of 2006, cannot be compared with 2005. STY's Reserve Life Index (RLI) of 7.2 and reserve replacement of 2.2 are considered good for junior E&P companies. F&D costs for the company increased from \$36.45 in 2005, to \$39.04 in 2006.

Increasing focus on South Alberta – Vulcan, Champion and Monarch

The company's 3 major areas of focus in 2007, and 2008, are Vulcan, Champion and Monarch, located in southwestern Alberta. STY used to operate only in northeast Alberta prior to the acquisition of Kinloch in 2005.



The company has a 59% WI on 11.7 net sections in Vulcan, a 83% WI on 15 net sections in Champion, and a 100% WI on 30 net sections at Monarch. There are 12 (5.8 net) producing wells at this time within this area, in addition to 50-75 net locations in inventory. Exxon Mobil (NYSE: XOM) and EnCana Corp (NYSE: ECA) have dominant land ownership in this area. Stylus's land interests lie along side, and in-between the lands owned by Exxon Mobil and EnCana. Stylus acquired both Vulcan and Champion in 2005. **Vulcan, which is estimated to have proved and probable reserves of 1.50 mm boe net, is now the biggest producer for STY.** Production at Vulcan is 1,150 boepd net, which is 56% of total production. STY achieved its production growth in 2006 primarily from Vulcan. **However, in 2007, and 2008, we expect Champion to be the main driver of production growth.** Champion is estimated to be of similar size as Vulcan (1.5 mm boe). Champion is currently producing 1 well at 20 boepd net. According to the latest reserve report, Champion has proved and probable reserves of 0.17 mm boe. We expect these figures to significantly increase as the company pursues more drilling in this area.

At Vulcan, the company discovered a new oil reservoir in Bow Island in November 2006. Management indicated that the reservoir is seen on 3D seismic. The discovery well was put into production at 25 (12.5 net) boepd. The company intends to drill another 4-5 wells in this area in 2007. The company is also pursuing construction of a pressure maintenance water flood project for the Vulcan Basal Mannville I oil pool in 2007, in order to produce oil at higher rates and to increase recoverable oil reserves from the pool.

STY has behind-pipe capability of about 300-350 boepd net at Champion. STY will pursue construction of a gas gathering pipeline (costing \$2.5 million) at Champion, followed by a multi-well drilling program. **Management expects the behind-pipe capability at Champion to be tied in by September-October of 2007.**

STY has farmed in about 37,000 net acres of land at Monarch. The template pools at Parkland (located southwest of Vulcan) are estimated to contain 25 mmbbls of original oil in place (OOIP) and 50 BCF of original gas in place (OGIP) in 3 oil pools and 1 gas pool. Monarch is located south of Parkland and hydrocarbons in the Parkland area are estimated to have migrated into the Monarch area (shown in the image on the previous page). Stylus believes that the Monarch area has good potential, and as a result, has planned active drilling in this area. However, since the company has a 100% WI in the area, drilling activities are proving to be quite expensive for the company. We expect STY might look for a partner at Monarch. We believe that operating Monarch with a partner will be a better strategy for a small/medium E&P company, like STY.

Drilling activity reduced, but success rates continues to be high in South Alberta:

STY drilled 38 wells in 2006, of which 50% were exploration wells and the remaining 50% were development wells. The 38 (25.2 net) well drill program resulted in 21 (13.9 net) gas wells and seven (3.9 net) oil wells, for a net success rate of 71%. The company's 2005 well program of 22 (11.7 net) wells had a net success rate of 66%. STY drilled 4 (3.25 net) wells in Q4-2006, resulting in 2 (2.0 net) gas wells at Champion and 1 (0.35 net) oil well at Vulcan for a 72% net success rate.

In 2006, STY drilled 14 (7.13 net) wells at Vulcan, with a success rate of 100% net, and drilled 10 (10 net) wells at Champion, also with a 100% net success rate. However, the company did not have any success from the 4 (4 net) exploration wells drilled in Monarch.

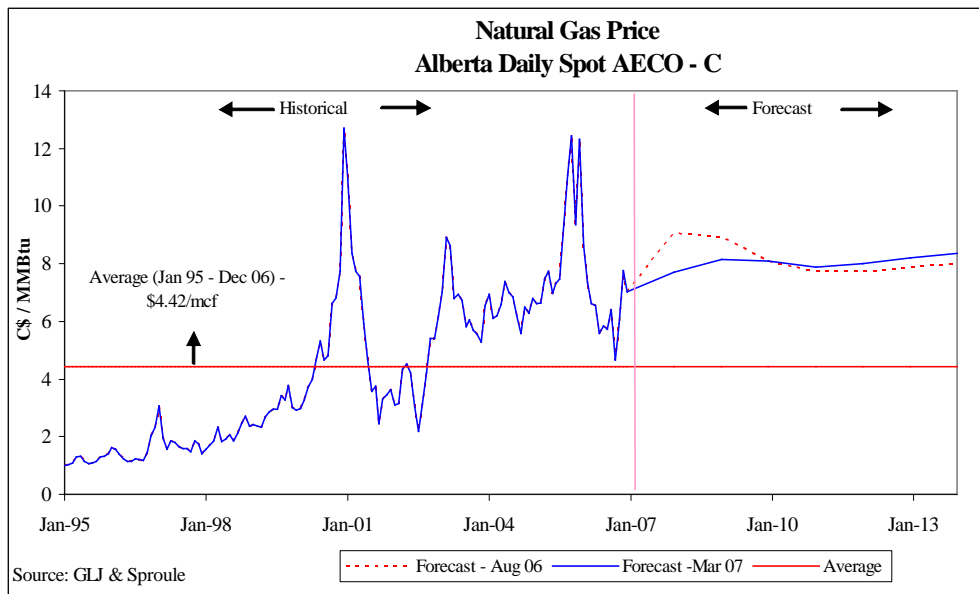
STY has planned a capital program costing \$22.8 million in 2007. The capital program will also include a 25 (19.0 net) well program, with 12 exploration wells and 13 development wells, in 2007. STY has already drilled 10 (5.1 net) wells in Q1-2007, including 3 (1.1 net) at Portage, 3.0 net wells at Monarch, 1.0 (1.10 net) at Champion and 3.0 (0.2 wells) minor interest non-operated wells.

***Outlook for
Natural Gas***

Supply and Demand of Natural Gas: Natural gas around the world is priced based on regional fundamentals (supply and demand), i.e., the prices vary from region to region because other than a small amount of LNG, it is hard to arbitrage gas. We believe that a study of supply and demand of natural gas in North America will help us predict the direction of future natural gas prices in the regions. The table below shows the supply and demand forecast of Natural Gas for North America according to the EIA.

North America Natural Gas Supply and Demand - in trillion cu. feet							
	2003	2010	2015	2020	2025	2030	Average 2003-30
Production	27.1	26.4	28.1	29.3	29.9	30.4	0.4%
Consumption	27.4	29.6	32.7	34.7	35.7	36.6	1.1%
Deficit	-0.3	-3.2	-4.6	-5.4	-5.8	-6.2	

The table clearly shows that demand will outpace supply both in the short-term and long-term. The average revised price forecasts for natural gas are shown below. The chart compares current price forecasts with forecasts 8 months ago. Note that, although short-term forecasts have dropped, the revised long-term forecasts are higher.



According to the average forecasts, natural gas prices are expected to stay above \$7.50 / mcf until 2013.

Outlook for Oil

World Supply and Demand of Oil: Unlike natural gas, crude oil prices are impacted by world supply and demand of oil. Prices worldwide tend to move in tandem because of the ability to transport oil more readily than natural gas. The table on the following page presents the forecasted world supply and demand of oil till 2030.

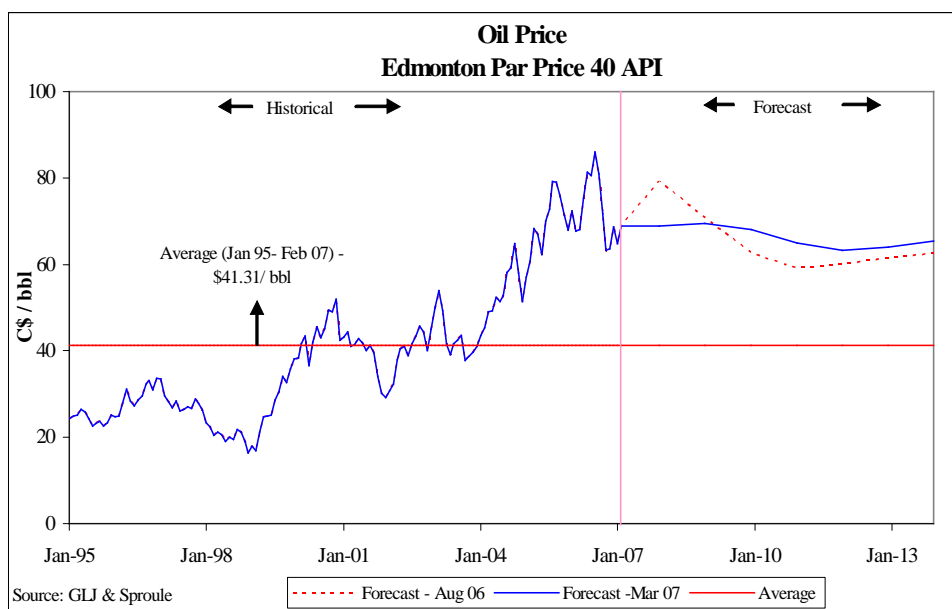
Production is expected to grow at a slower pace than consumption: The table below shows the expected growth in global production. According to the EIA, global production capacity is expected to rise from 82.3 million bpd in 2003, to 123.30 million bpd by 2030, which reflects a CAGR of 1.5%. Production capacity is expected to increase at a slightly faster rate in OPEC countries (1.6%), while growth in OECD countries is relatively lower (0.4%).

World Oil Production Capacity (1990 - 2030) - mmbpd								
	1990	2003	2010	2015	2020	2025	2030	CAGR 2003-2030
OPEC	27.10	33.00	39.90	42.80	43.90	46.70	50.70	1.6%
OECD	20.10	23.20	24.30	24.70	25.50	26.00	26.10	0.4%
World	69.5	82.30	94.30	101.60	107.60	114.90	123.30	1.5%

Source: EIA

Global consumption of oil is expected to rise by a CAGR of 1.9% during 2002-2025. The supply-demand forecasts show that prices will likely stay at current levels or appreciate going forward.

Price Forecasts: Based on fundamentals, we expect prices to stay above historical averages (\$32.16/bbl during 1997-2006). The chart below shows historical and forecast oil prices. The average WTI Cushing Oklahoma oil price in 2006 was US\$66.09/bbl, compared to \$56.58/bbl in 2005, an increase of 16.7%. Prices have increased by 118.7% since 2000, when the average price was only \$30.22/bbl. As with natural gas, oil prices are expected to remain above historical averages (\$32.16/bbl during 1996-2006) through to 2017. Based on the forecasts, prices are expected to stay around \$60.00/bbl until 2017. The chart below shows the average revised forecasts for oil.



Similar to natural gas, short-term forecasts for oil prices have dropped, but the long-term forecasts have increased. According to the average forecast, oil prices are expected to stay close to \$55.00/bbl until 2013.

Review of Financials

Production revenues below expectations: Production revenues in Q4-2006 were \$6.29 million, compared to \$5.93 million during the same period in the previous year, an increase of 5.9%. Revenues in FY2006 increased by 5.4% YOY, from \$21.21 million in FY2005, to \$22.36 million in FY2006. Although revenues increased YOY, they were below expectations

(our estimate for FY2006 revenues were \$23.54 million), primarily, because of lower production (mentioned earlier in the report) and commodity prices.

Although average gas prices increased QOQ in Q4-2006, from \$5.78/mcf to \$7.23/mcf, oil prices fell drastically during the period from \$76.45/bbl to \$54.80/bbl. Natural gas production as a percentage of total production has been steadily decreasing since the company started producing in Vulcan. Natural gas production as a percentage of total production in Q4-2006 was 81.1%, compared to 87.0% during the same period in the previous year. Natural gas production in FY2006 was 83.9% of total production, compared to 88.2% in FY2005. We are pleased to see natural gas production declining, as we believe that a balanced oil-gas production profile diversifies the risks of any E&P company.

Based on our production forecasts (mentioned earlier in the report), we revise our revenue forecasts for FY2007, and FY2008. Our revised production revenue estimates are \$39.47 million in FY2007 (previous estimate - \$42.68 million), and \$45.80 million in FY2008 (previous estimate - \$53.87 million).

Netbacks: The chart below shows the company's netbacks in FY2006, along with our forecasts.

Netbacks (C\$ / boe)					
	2004A	2005A	2006A	2007E	2008E
Production - boepd	543	1,056	1,383	2,250	2,500
Production Revenue	38.77	55.04	44.29	48.07	50.19
Royalties	15.7%	13.6%	20.1%	20.0%	20.0%
Production Costs	9.55	11.89	11.32	10.32	10.32
Transportation Costs	1.16	1.27	1.21	1.21	1.21
Operating Netback	21.96	34.42	22.86	26.92	28.62
General & Admin Costs	7.52	6.43	5.14	5.14	5.14
DD&A Costs	17.76	20.80	25.62	19.91	21.62
Stock Based Compensation	0.26	0.97	1.82	1.45	1.45
Capex(excl. acquisitions) - mm	6.70	21.22	37.65	22.80	22.50
RLI (Proved & Probable) - years	4.9	8.9	7.4	5.8	5.7

Although the company had higher production revenues per boe in Q4-2006, compared to the previous quarter, higher production costs and general & administrative (G&A) expenses offset most of the increase in revenues, and as a result, operating netbacks in Q4-2006 were \$21.71, only slightly above the \$21.46 achieved in Q3-2006. Operating netbacks in FY2006 were \$22.86, compared to \$34.42 in the previous year.

Production expenses in Q4-2006, were \$1.89 million (\$13.83 / boe) compared to \$1.33 million (\$9.48 / boe) in Q3-2006. Production expenses in FY2006 were \$5.71 million (\$11.32 / boe), compared to \$4.58 million (\$11.89 / boe). Production expenses were higher in Q4-2006 due to non-recurring costs. STY attributes the increase in production costs to non-recurring expenses for plant repair, maintenance equipment rentals and overhead recovery adjustment. These non-recurring costs added \$1.52 / boe to total production costs in Q4-2006. Also, STY had to pay additional operating charges (\$1.05 per total production in Q4-2006) to a mid-stream gas processor at Burnt Pine. STY produces about 50 boepd net in

this area. STY has not agreed to pay such additional charges going forward, and is trying to determine mutually acceptable charges at Burnt Pine.

If these non-recurring costs were removed from production costs, we believe other costs would have been more in line with our estimates.

G&A expenses in Q4-2006 were \$0.73 million (\$5.37 / boe), compared to \$0.59 million (\$4.20 / boe) in Q3-2006. G&A expenses in 2006 were \$2.60 million (\$5.14 / boe), compared to \$2.47 million (\$6.43 / boe) in FY2005. The increase in G&A expenses was due to increased salary costs and consulting costs associated with the design of the company's internal controls.

We have slightly increased our forecasts for G&A expenses in FY2007, and FY2008, however, we maintain our forecasts for production costs, as most of the increases in FY2006 were due to non-recurring costs.

A significant increase in non-cash depletion, depreciation and amortization (DD&A) costs had a significant negative impact on the company's bottom line in FY2006, compared to previous years. DD&A expenses in FY2006 were \$12.94 million, compared to \$8.01 million in FY2005. D&A expenses are high, as the company calculates DD&A based on its proved reserves. DD&A costs are expected to decline as the company moves its probable reserves to proved reserves.

Bottom line was significantly lower than expected: The company had a net loss of \$3.64 million (eps: -\$0.14) in FY2006, compared to a net profit of \$1.54 million (eps: \$0.08) in FY2005. Q4-2006 net losses were \$1.69 million (eps: -\$0.06), compared to a net loss of \$1.13 million (eps: -\$0.04) during the same period last year. Net losses increased due to lower production revenue and higher cash and non-cash costs per boe.

Based on the revisions to our forecasts, we have revised downward our eps forecasts for FY2007, and FY2008. We expect STY to have net losses of \$0.22 million (eps: -\$0.01) in FY2007, and \$0.19 million (eps: -\$0.01) in FY2008. Our previous forecasts were net profits of \$2.10 million (eps: \$0.08) in FY2007, and \$4.18 million (eps: \$0.16)

Cash Flows and Liquidity

Cash and working capital at the end of FY2006 were \$0.14 million, and (\$23.02 million), compared to \$0.25 million, and (\$7.09 million) at the end of FY2005. The table on the next page shows a few important liquidity ratios.

	2004A	2005A	2006A	2007E	2008E
Current Ratio	1.19	0.54	0.30	0.41	0.45
Working Capital	1,181,004	(7,090,477)	(23,023,961)	(23,541,696)	(23,731,085)
Debt / Capital	0.0%	7.1%	26.3%	26.2%	26.3%
Interest Coverage	(8.05)	7.33	(5.04)	0.76	0.80
Days Sales Outstanding	178	118	138	128	128
Days Payables Outstanding	621	541	457	457	459

Operating Cash Flows: Since the company incurred net losses in 2006, STY's operating cash flows in FY2006 were lower than 2005 levels. Operating cash flows in FY2006 were \$7.64 million (\$0.60 million from working capital investment), compared to \$9.83 million (\$0.54 million towards working capital investment) in 2005.

The company's DSO (days sales outstanding) increased from 118 days to 138 days, while its DPO (days payables outstanding – which includes accounts payables and accrued liabilities) decreased from 541 days to 457 days. We believe the company has good cash management, primarily because its DPO are much higher than DSO.

Capital Expenditures: During 2006, Stylus spent \$37.46 million on CAPEX. Approximately 73% of the CAPEX was invested in expanding STY's South Alberta areas at Vulcan, Champion and Monarch. In 2006, STY spent \$15.3 million at Vulcan, and \$13.5 million at Champion and Monarch. Included in the costs at Monarch and Champion are \$7.6 million for 3D seismic and undeveloped land. During 2006, STY also sold two minor properties for net proceeds of \$1.78 million.

Financings: In order to fund its CAPEX, the company raised \$15.5 million through 2 brokered private placements, in addition to the \$17 million that it drew from its credit facility of \$23 million with a Canadian chartered bank. As of December 2006, the company had drawn \$20.8 million against the facility at 6.0% per annum. Debt to Capital at the end of FY2006 was 26.3%.

Private Placements - Stylus completed two brokered private placements in FY2006. In the first private placement, the company raised \$10 million by issuing 2.11 million flow-through shares at a price of \$4.75 per flow-through common share. In the second private placement, STY raised \$5.5 million by issuing 1.34 million flow-through shares at price of \$4.10 per flow-through common share.

Options Outstanding: At the end of 2006, STY had 2.28 million stock options with a weighted average time to expiry of 2.86 years and weighted average exercise price of \$2.46.

Valuation

Our revised NAV valuation is shown below.

Net Asset Value					
	0%	5%	10%	15%	20%
NPV (before tax)	\$97,880,678	\$85,715,741	\$75,796,823	\$67,612,422	\$60,785,872
NPV	\$97,062,495	\$85,066,806	\$75,276,546	\$67,191,176	\$60,441,729
Less Liabilities	-				
Value of Undeveloped Lands	\$20,197,500				
Working Capital	(\$23,023,961)				
NAV (@ 10%)	\$72,450,085				
No of outstanding shares	27,670,910				
NAV / Share	\$2.62				
Current Premium (@ \$1.96 per share)	-25%				
Estimated Premium (CAGR of Revenues)	43%				
Fair Value of Stock	\$3.75				

Although reserve estimates increased, slightly lower short-term forecasts for production and commodity prices led to a decline in the NAV estimate from \$2.68 to \$2.62. Applying a premium of 43% (2 year CAGR of revenues) to the revised NAV, we obtain a revised fair value of \$3.75 (slightly down from our previous estimate of \$3.77). At current price levels, STY is trading at a 25% discount to its NAV.

Comparables Valuation: Like STY, the prices of most juniors have dropped significantly since our previous report in November 2006. Our revised comparables valuation, based on 3 multiples, is \$3.73 (down from our previous estimate of \$4.05). The valuation declined due to lower short-term production forecasts and a decline in average multiples.

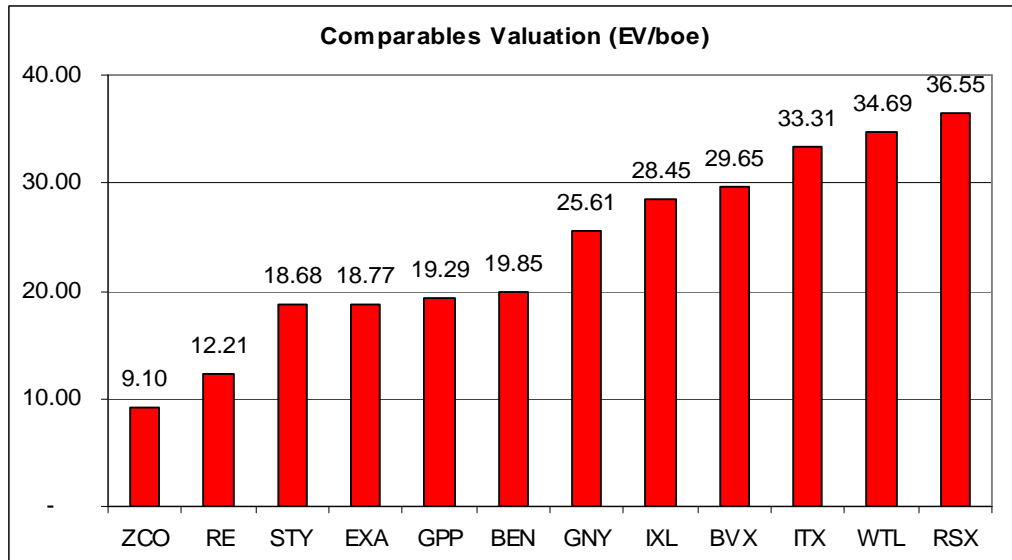
COMPARABLES VALUATION									
	Company	Symbol	Price	Mkt Cap	boepd	RLI (P+P)	EV / DACF	RLI / (EV/DACF)	EV / EBITDA
1	Zapata Energy Corp	ZCO	3.96	68.97	3,200	9.5	3.7	2.6	4.0
2	Innova Exploration Ltd	IXL	5.43	240.95	3,738	6.8	6.8	1.0	6.0
3	ExAlta Energy Inc	EXA	2.10	74.80	2,550	6.3	5.3	1.2	6.0
4	West Energy Ltd	WTL	4.40	284.76	4,000	5.9	9.8	0.6	8.6
5	Grand Petroleum Inc	GPP	3.35	88.07	2,755	6.0	5.6	1.1	4.2
6	Berens Energy	BEN	1.12	104.10	4,200	6.0	9.6	0.6	6.1
7	Rock Energy	RE	4.00	78.55	2,200	9.1	5.2	1.8	6.5
8	Gentry Resources Ltd.	GNV	3.96	153.88	4,335	7.6	5.1	1.5	6.2
9	Iteration Energy Ltd	ITX	5.88	339.71	6,050	4.9	11.1	0.4	10.3
10	RSX Energy Inc	RSX	2.70	149.12	1,800	6.8	14.9	0.5	17.6
11	Bow Valley Energy Ltd	BVX	6.17	451.71	2,443	19.3	8.9	2.2	23.8
12	Stylus Energy Inc. ^x	STY	1.96	54.23	2,100	5.8	4.1	1.4	4.3
	Average			174.1	3,281	7.840	7.5	1.2	8.6

* EBITDA, DACF and RLI - FY2007 estimates

FY2007 Estimates (\$ millions)		
EBITDA	DACF	RLI
17.35	18.07	5.82

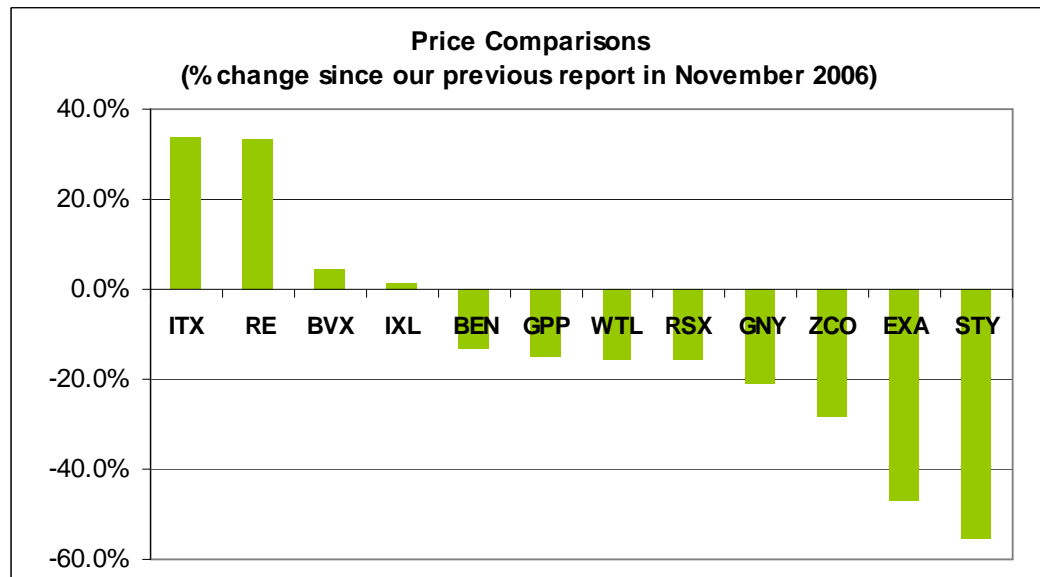
Fair Value of STY stock	
EV / DACF	\$4.17
RLI / (EV / DACF)	\$2.34
EV / EBITDA	\$4.68
Average	\$3.73

Enterprise Value / boe comparison: The chart below shows STY’s EV/boe compared to its peers. The chart shows that STY is undervalued compared to 8 out of 11 peers. The EV / boe of STY is 18.68, compared to the average EV/ boe ratio of 21.16.



Rating

Based on our valuation models and review of the industry, we reiterate our BUY rating (Risk 3: Average), but reduce our fair value from \$4.50 to \$3.75. STY has declined considerably since our last report in November 2006. The chart on the next page shows that compared with its peers, STY has declined the most since November 2006.



Our revised fair value estimate reflects a 91.3% upside potential from current price levels.

Risks

The following risks may cause our estimates to differ from actual results.

- **Volatility of Commodity Prices** - As revenues are directly related to commodity prices, the growth and profitability of Stylus will depend heavily on future natural gas and oil prices.
- **Weather** - Natural gas demand depends heavily on weather conditions. Colder winters and warmer summers will improve natural gas sales.
- **Drilling Success** - Like all junior oil and gas exploration and production companies, Stylus forecasts growth in 2007 production revenues based on drilling successes. If its success rate is lower than estimated, lower revenues should be expected.
- **Exploration, Development and Production Risk** - The ability to grow depends heavily on the ability to explore, develop properties and acquire suitable producing properties. Only by consistent performance in all these above-mentioned factors, can a junior company maintain sustainable growth.
- **Highly competitive industry** - Stylus will have to keep focusing on acquisitions in order to grow its production rate. Based on its current reserves, we believe that, Stylus can achieve 3,000 boepd by the end of 2007, or early 2008. Further growth in production can only be achieved with aggressive acquisitions.
- **Government Regulations** - Oil and natural gas operations are subject to extensive regulations imposed by the government. Operational delays could arise due to the delay in obtaining permits and licenses.

Appendix

Consolidated Statements of Income (Loss) and Retained Earnings

YE - December 31 (all figures in C\$)

	2004A	2005A	2006A	2007E	2008E
Revenue					
Production Revenue	7,703,744	21,208,165	22,357,569	39,474,392	45,797,062
Royalties, net of Alberta Royalty Tax Credit	(1,211,134)	(2,874,675)	(4,492,686)	(7,894,878)	(9,159,412)
Interest and other income	94,431	24,759	44,829	44,829	44,829
Total Revenue	6,587,041	18,358,249	17,909,712	31,624,343	36,682,478
Expenses					
Production	1,897,165	4,581,815	5,712,711	8,127,000	9,030,000
Transportation expense	231,309	488,418	610,606	952,875	1,058,750
G & A	1,494,890	2,473,709	2,595,939	4,047,750	4,497,500
Stock based compensation	52,635	375,628	523,097	1,145,644	1,272,938
Interest Expense	84,100	330,643	886,973	1,307,776	1,367,776
Depletion, Depreciation and Accretion	3,528,835	8,013,484	12,934,375	16,354,375	19,729,375
Inventory Valuation adjustment	59,249				
Total Expenses	7,348,183	16,263,697	23,263,701	31,935,419	36,956,338
					-
Income before Taxes and Gains	(761,142)	2,094,552	(5,353,989)	(311,077)	(273,860)
Gain on sale of assets		-			-
Income(Loss) before Income Taxes	(761,142)	2,094,552	(5,353,989)	(311,077)	(273,860)
Income Tax					
Large Corporations tax		15,000	(12,579)		
Future Income tax(recovery)		535,387	(1,700,956)	(93,323)	(82,158)
Net Income(loss) for the year	(761,142)	1,544,165	(3,640,454)	(217,754)	(191,702)
Retained Earnings, beginning of the year	2,384,746	1,495,722	3,039,887	(600,568)	(818,322)
Accounting changes and others(elimination of deficit)	(127,882)				
Retained Earnings, end of the year	1,495,722	3,039,887	(600,568)	(818,322)	(1,010,024)
Net Income(loss) per common share - basic	(0.07)	0.08	(0.14)	(0.01)	(0.01)
Weighted average number of shares - basic	10,742,433	20,051,406	25,277,172	27,670,910	27,670,910

Consolidated Balance Sheets**YE - December 31 (all figures in C\$)**

	2004A	2005A	2006A	2007E	2008E
Assets					
Current					
Cash	2,739,597	252,257	138,182	97,038	316,886
Restricted cash	505,382				
Accounts receivable	3,750,576	6,839,913	8,461,400	13,835,205	16,051,210
Prepaid expenses & Deposits	259,045	385,077	435,400	742,738	861,704
Inventory	238,986	804,469	1,005,614	1,636,425	1,898,534
Total Current Assets	7,493,586	8,281,716	10,040,596	16,311,407	19,128,333
Property and Equipment	16,317,434	59,300,772	86,996,721	93,442,346	96,212,971
Goodwill		65,795	65,795	65,795	65,795
Total Assets	23,811,020	67,648,283	97,103,112	109,819,548	115,407,099
Liabilities and Shareholders Equity					
Current					
Accounts payable and accrued liabilities	6,312,582	11,678,459	12,268,297	18,056,843	20,063,159
Bank Loan		3,693,734	20,796,260	21,796,260	22,796,260
Total Current Liabilities	6,312,582	15,372,193	33,064,557	39,853,103	42,859,419
Asset retirement obligations	1,135,187	3,338,000	5,164,747	5,164,747	5,164,747
Future Income taxes		966,550	658,980	3,558,980	3,558,980
Commitment and Contingencies					
Shareholders' Equity					
Share capital	14,810,994	44,427,145	57,761,502	59,861,502	61,361,502
Contributed surplus	56,535	504,508	1,053,894	2,199,538	3,472,475
Retained Earnings	1,495,722	3,039,887	(600,568)	(818,322)	(1,010,024)
Total Shareholders' Equity	16,363,251	47,971,540	58,214,828	61,242,718	63,823,954
Total Liabilities and Shareholders E	23,811,020	67,648,283	97,103,112	109,819,548	115,407,099

Consolidated Statements of Cash Flows**YE - December 31 (all figures in C\$)**

	2004A	2005A	2006A	2007E	2008E
Operating Activities					
Net Income(loss) for the year	(761,142)	1,544,165	(3,640,454)	(217,754)	(191,702)
Add(deduct)items not requiring cash					
Depletion and Depreciation	3,491,908	7,863,267	12,734,667	16,354,375	19,729,375
Interest on restricted cash		(5,593)			
Stock based compensation	52,635	375,628	523,097	1,145,644	1,272,938
Inventory valuation adjustment	59,249				
Accretion Expense	36,927	150,217	199,708		
Future Income taxes		535,387	(1,700,956)		
Fund Flow from Operations	2,879,577	10,463,071	8,116,062	17,282,265	20,810,611
Asset retirement expenditures		(91,142)	(1,070,316)		
Net change in non-cash working capital	(579,403)	(541,748)	596,800	(523,409)	(590,763)
	2,300,174	9,830,181	7,642,546	16,758,856	20,219,848
		10,306,675			
Financing Activities					
Proceeds from Issuance of common shares	3,000,000	10,520,494	15,711,002	5,000,000	1,500,000
Share Issue costs	(184,152)	(1,156,195)	(1,038,049)		
Increase in bank loan		(3,324,693)	17,102,526	1,000,000	1,000,000
	2,815,848	6,039,606	31,775,479	6,000,000	2,500,000
		5,563,112			
Investing Activities					
Expenditures on Property and Equipment	(11,400,891)	(20,718,701)	(39,432,183)	(22,800,000)	(22,500,000)
Proceeds on disposal of properties			1,780,000		
Restricted Cash	701,953	510,975			
Cash paid upon acquisition, net of cash acquired		(90,257)			
Business acquisition transaction costs		(149,283)			
Net change in non-cash working capital	3,275,799	2,090,139	(1,879,917)		
	(7,423,139)	(18,357,127)	(39,532,100)	(22,800,000)	(22,500,000)
Decrease in cash	(2,307,117)	(2,487,340)	(114,075)	(41,144)	219,848
Cash, beginning of the year	5,046,714	2,739,597	252,257	138,182	97,038
Cash, end of the year	2,739,597	252,257	138,182	97,038	316,886

Fundamental Research Corp. Equity Rating Scale:

Buy – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

Hold – Annual expected rate of return is between 5% and 12%

Sell – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

Suspended or Rating N/A— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

Fundamental Research Corp. Risk Rating Scale:

1 (Low Risk) - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

2 (Below Average Risk) - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

3 (Average Risk) - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

4 (Speculative) - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

5 (Highly Speculative) - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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